A Conversation With IPO Icon Lise Buyer

Interview by Adam J. Epstein

Lise Buyer is the principal and founder of the Class V Group, which provides strategic and logistical guidance to companies planning initial public offerings (IPOs). Class V helps management teams master and control their IPO process, from structural nuance to banker selection to the public release of quarterly results. Buyer has comprehensive experience in the IPO process, having been a top-ranked institutional investor at T. Rowe Price, No. 1 research quality sell-side analyst at Credit Suisse First Boston, and internal IPO designer/coordinator for Google, where she received the Google Founders' Award. Buyer also was a board member of Greenfield Online, serving on its mergers and acquisitions committee, until the company was acquired by Microsoft. Buyer also is a past fellow of the Davos World Economic Forum.

Lise Buyer

You were credited with being the architect of Google's highly successful IPO. What were the principal takeaways from that experience, and how applicable are they a little more than nine years later?

Let's start with the fact that the Google IPO was very much a team effort. A group of us worked to implement the founders' ideas and plans for a broader and arguably fairer distribution of IPO shares. What did we learn from architecting a unique Dutch auction?

- "That's how it's always been done" is never the right answer when structuring an IPO. Each company has slightly different reasons for and concerns with going public, and every IPO should—and can—be optimized for the specific issuer. Sadly, most don't ask.
- Within the bounds of Securities and Exchange Commission rules, there is greater flexibility in how an IPO can be executed well.
- Institutional investors will accept well-reasoned deviations from standard practice, but will stomp on the inane.

All three takeaways are as applicable now as they were then.

The IPO market hasn't yet returned to pre-2008 levels. Moreover, there are those who believe that the IPO market is fundamentally broken (e.g., 75 percent fewer IPOs annually than in the 1990s, a comparative dearth of "small IPOs," and material degradation in the number of exchange-listed companies). Was the onset of decimalization in the late 1990s the beginning of the end of the IPO market, or is the structural death of the IPO market overstated?

Those aiming to fix a broken IPO market are tilting at windmills. While whining about how the market is broken is a popular refrain by IPO share sellers, if you examine the data, you will see that we are doing as many venture-backed IPOs now as we did back in the "glory days" of the 1980s to mid-1990s. Yes, if one's starting point is the deal count in the late 1990s, then there are fewer IPOs today. That analysis, however, conveniently ignores the fact that the vast majority of those Internet IPOs made a beeline to oblivion within 24 months, sadly turning billions of investors' dollars and fantasies of easy money into deep black holes of nothingness.

The IPO market very closely parallels the market's volatility index (VIX). When markets are less volatile, investors are willing to overlook the incremental risk inherent in IPOs as they seek the greater potential reward new issues may offer. At other times, when markets are skittish—for example, when Internet investments imploded, during the mortgage crisis, or debt ceiling brinksmanship—investors tend to "flee to safety" preferring to trust in securities characterized by reduced risk but lower expected rewards. IPO ebbs and flows track the market's appetite for risk, also evident by the trends in mutual fund inflows. Since early this year, mutual funds have seen more money in than money out, the VIX is well below 30, and, not surprisingly, as of last week the number of IPOs was up 30 percent year-over-year, with a robust calendar ahead.

Decimalization is the latest scapegoat for those who refuse to acknowledge that the main reason there are fewer small IPOs is that there are few customers for them. There is so much more money invested in tech funds now as compared to 20 years ago that small deals just aren't worth the effort. Even if a fund's full position in a recent small-cap issue quadruples, it still won't improve overall performance for most tech and growth funds. A \$3 million position that grows to \$12 million isn't really going to help the manager of a \$2 billion fund.

Nonetheless, there is a movement afoot to tax traders in sub-\$500 million market-cap funds by increasing the "tick" size on those trades relative to larger companies. The hope is that brokerage firms will use a portion of their increased profits, not to compensate the traders doing the work, but to subsidize research on these smaller companies, possibly increasing investor interest.

Alas, there is significant magical thinking in that line of reasoning. For starters, one can't ignore the conflicts that might arise from increasing incentives for brokerages to trade certain stocks more frequently than others—incentives that are good for traders but do nothing to improve the fundamental suitability or potential profitability of those stocks for the potential investor.

You've seen IPOs from every imaginable angle: employee, institutional investor, banker, analyst, and venture capitalist. When it comes to achieving both a high valuation and compelling aftermarket performance, what are the most common IPO mistakes, and why do they seem to happen over and over again?

In terms of aftermarket performance, nothing is more important than business performance. Investors know that the guidance for the first few quarters is generally conservative, so companies that miss those estimates signal to Wall Street that they don't have a firm grip on their business financials. Miss early, and it will be a very long, slow climb back to credibility.

A second mistake is underestimating the process. Going public takes a great deal of time and effort; each transaction has many nuances. We frequently run into board members who, because they have watched IPOs from the director's seat or been in pitches or on pricing calls, think they understand the nitty-gritty parts of the process. These same groups are too often surprised when the timing doesn't work out as their pre-deal flow chart suggested or when valuations don't match what the bankers pitched at the bakeoff.

Finally, companies and boards too often cede complete control of their IPO to the lead bankers. Management needs to remember that long after the bell-ringing ceremony they will have to live with and defend the decisions made along the way. Whether it's an appropriate lock-up structure, the messaging, the accounts visited on the road show, or even IPO share allocations, management needs to take responsibility and be actively engaged in all the final decisions. Because this is unfamiliar territory, they too often hand the reins to the bankers, walking docilely behind without asking enough questions. Too often, they regret that abdication in the quarters and years to follow.

In May, Class V Group publicly underscored the need for officers and directors of pre-IPO small-cap companies to give a more prominent role in their IPOs to smaller, boutique investment banks versus larger, bulge-bracket investment banks. Why?

There is no question that having one of the large, prestigious banks lead an IPO adds credibility to a transaction. Once the deal is done, however, what matters most to Wall Street is that companies deliver as promised and that there is adequate ongoing information flow. In general, unless an IPO is of the scale of Google, Facebook, or Workday, that ongoing research initially comes from the banks involved in the underwriting. There's the rub. The large multinational firms in general pragmatically allocate resources, including research effort, to those stocks that will be of interest to the greatest number of potential customers. More bank clients are interested in Apple than in Audience, in Verizon than Vocera. Therefore, in general, big banks focus on big stocks while the boutiques need to earn their stripes on the emerging, not the already evident winners. New issues unlikely to blast out of the gate with valuations above \$5 billion should take this into account when building an underwriting syndicate: hire and offer incentive both to those charged with executing the IPO and those you will need to rely on ever afterward. D

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